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Executive Secretary

12/12/83

Date

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THE SECRETARY OF THE TREASURY
WASHINGTON 20220

December 12, 1983

UNCLASSIFIED
(With Confidential Attachment)

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT & DEPUTY TO THE CHIEF OF STAFF
ASSISTANT TO THE PRESIDENT FOR CABINET AFFAIRS
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

A meeting of the SIG-IEP is scheduled to be held on Wednesday, December 14, 1983, at 2:00 p.m., in the Roosevelt Room. The agenda is as follows:

1. U.S.-E.C. Ministerial Report;
2. Report on Slave Labor Imports;
3. Food Aid to Egypt; and
4. International Debt Update.

Agenda items 1, 2, and 4 will be oral reports. A discussion paper on agenda item 3 is attached.

Attendance will be principal, plus one.

DTR

Donald T. Regan

Attachment

DCI EXEC REG

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Additional Food Assistance for Egypt

INTRODUCTION

The SIG-IEP asked that a work group look at ways for providing economic assistance to Egypt through additional food shipments. Among the major products imported by Egypt, which could be provided by the United States, are wheat, wheat flour, dairy products and poultry.

All of the food assistance options run into three problems:

(1) Bilateral frictions with other food suppliers, particularly the EC.

Egyptian imports of wheat flour and dairy products are supplied largely by the European Community (EC), except for our sales in 1983 and our annual sale of wheat flour under P.L. 480. The EC shares the Egyptian market for wheat and poultry with other suppliers (the United States and Australia for wheat, and Brazil and the United States for poultry). Of these suppliers, the EC provides substantial agricultural export subsidies; Brazil has subsidized its exports of poultry.

(2) Possible inconsistencies with international rules -- GATT subsidy rules for commercial sales or FAO Principles on Surplus Disposal for food aid.

The GATT Subsidies Code says that countries should not use export subsidies (1) to gain more than an equitable share of world exports (usually defined as more than its historical share) or (2) to undercut materially prices charged by other suppliers in a particular market. The FAO Principles on Surplus Disposal say that food aid should neither undercut commercial imports nor be a disincentive to local food production.

(3) Inconsistencies with USG, IMF and World Bank efforts.

Together we are encouraging Egypt (a) to reduce subsidies that promote excess consumption and discourage domestic production and (b) to lessen government involvement in, and control of, food distribution and marketing.

The IG-IEP reviewed many options. No agency strongly supported any of these options. However, the IG-IEP agreed to propose for SIG-IEP consideration four options, which provide additional food aid to Egypt. They follow below.

OPTIONS

I. Donate or sell dairy products to Egypt. The United States could use Section 416 of the Agricultural Act of 1949 to donate surplus dairy products to the Government of Egypt or to a recognized charitable organization for distribution to needy people. The Commodity Credit Corporation (CCC) could also sell dairy products to Egypt along the lines of the prior $42 million sale in 1983. (See background section on the prior sale.) The U.S. Embassy in Cairo has received informal inquiries about the possibility of another sale of dairy products.

Pros

-- Would help Egypt meet food import needs (at little or no cost to the Egyptian Government, if donated).

-- Would reduce costly surplus CCC dairy stocks.

Cons

-- A sale could interfere with normal commercial sales of other supplying nations and would be challenged in the GATT International Dairy Council, particularly in the wake of our recent dairy sale to Egypt. A donation would need to be shown consistent with U.S. obligations under FAO Principles on Surplus Disposal.

-- A sale would be seen as a hostile act by the EC; even a donation could be an irritant. Either would particularly hurt the Dutch, who have supported us by opposing the EC Commission's proposals to tax fats and oils and to restrict imports of non-grain feeds.

-- Distribution of substantial amounts of donated dairy products would undermine the Egyptian dairy sector, which is one of the few major agricultural areas without extensive government controls.

II. Another wheat flour sale similar to the sale earlier this year. CCC would compensate either U.S. flour millers or the Egyptian Government directly for the high price of U.S. wheat flour with surplus CCC wheat.

Pros

-- Would add to total U.S. wheat/wheat flour export volume, benefiting U.S. wheat farmers. (Large farmer-owned stocks of wheat remain.)

-- Could strengthen our leverage in our negotiations with the EC on its use of agricultural export subsidies by showing that the United States is willing to use export subsidies to displace subsidized EC sales.

-- Would provide a commodity desired by Egypt (it has asked for more U.S. wheat flour) at prices probably a little lower than those of alternative suppliers. If combined with GSM-102 loan guarantees, could provide some balance of payments assistance since Egypt would receive a 3-year government guaranteed credit with repayment beginning one year after shipment.

Cons

-- Could not be undertaken until May 1984, the end of the growing season, when it will be known whether the CCC will have surplus wheat. (According to USDA projections, useable CCC wheat stocks will not exceed 1/2 million tons. For the previous 1-million-ton sale of wheat flour to Egypt, CCC needed 1.23 million metric tons of wheat to lower our flour prices.)

-- Would encourage the U.S. milling industry to consider wheat flour sales subsidized by the U.S. Government as an entitlement.

-- Would continue and expand U.S. Government association with subsidized Egyptian imports of wheat and flour, which make possible the Egyptian Government's sale of bread at low prices, encouraging waste. Unless linked to economic reforms, would contradict the signal the U.S. Government intends to send by committing to decrease P.L. 480 (Title I) to Egypt.

-- Would be considered another shot across the bow by the EC and could be used as a pretext for EC retaliation.

-- Could complicate our efforts to defend in the GATT our previous subsidized sale of wheat flour to Egypt.

The last two cons would be less important, however, if the sale amounted to significantly less than the previous 1 million ton subsidized sale by the U.S.

III. Additional blended credits for Egypt. The U.S. Government has already authorized $120 million in blended credits to Egypt in FY 1984 (750 thousand metric tons of wheat). If we provide another $500 million in blended credits, we could meet virtually all Egypt's import needs for wheat and corn, excluding that met by P.L. 480 and by Australia. This would amount to as much as 2.3 million metric tons of wheat and up to about 1.5 million metric tons of corn.

Pros

-- If we provided a total blended credit package of $620 million, it would displace 1 to 2 million metric tons of EC grain exports to Egypt and reduce EC annual grain exports by 300,000 to 500,000 metric tons.

-- Would provide Egypt with 3-year credits at about 80 percent of commercial interest rates, or about 2 percentage points below current rates.

-- Would provide a significant balance of payments advantage to Egypt because repayment would not begin for one year and would not be completed for three years.

-- Could strengthen our leverage in our negotiations with the EC on the use of agricultural export subsidies.

Cons

-- Could adversely affect U.S.-EC relations.

-- Would require (1) expansion of the FY 84 budget ceiling for CCC guarantees (which is under consideration by the Budget Review Board) and (2) additional FY 84 authorization of interest-free GSM-5 direct credits.

-- Would divert from LDC debtors scarce CCC guarantees need for the blended credit package.

-- If it displaces normal EC shipments (even though they benefit from export subsidies), could be found inconsistent with U.S. obligations under the GATT Subsidies Code.

-- Unless linked to economic reforms, would contradict the signal the USG intends to send by committing to decrease P.L. 480 (Title I) to Egypt.

IV. Expand GSM-102 credit guarantees for agricultural exports to Egypt. The National Advisory Council (NAC) has already authorized $116 million in 3-year GSM-102 guarantees for Egypt in FY 84.

Pros

-- Would provide a significant balance of payments advantage to Egypt because repayment would not begin for one year and would not be completed for three years.

-- No U.S. Government funds are needed.

Cons

-- Less attractive to the Egyptians than the other alternatives outlined above. The loan is at commercial interest rates, but the generous 3-year terms have not been offered Egypt by others. (The Egyptians may prefer GSM-102 to nothing.)

-- Would require an increase in the FY 84 budget ceiling for CCC guarantees (currently under review).

-- Would divert scarce CCC guarantees from other LDC debtors.

V. Provide no additional food assistance.

Pros

-- Would not reduce Egypt's incentive to seek a multilateral solution to its debt problems, including negotiation of an IMF economic stabilization program addressing its fundamental economic problems.

-- Avoids (1) increased bilateral tensions with other food suppliers (especially the EC), and (2) inconsistencies with our international commitments on export subsidies and surplus food disposal.

Cons

-- Does not address (1) the special role Egypt plays in our Middle East policy, or (2) that, unlike most other debtor countries, much of Egypt's debt is military assistance loans owed the U.S. Government, not commercial loans.

NON-FOOD ASSISTANCE OPTIONS

This paper does not attempt to analyze possible non-food aid options for assisting Egypt. However, one possibility might be to expand our non-food assistance. Currently our non-food assistance (other than military assistance) is exclusively the $750 million provided under the Economic Support Fund ($300 million for balance of payments support and $450 million for individual projects). To increase ESF for Egypt would require going back to Congress for additional authorization.

Another alternative could be to extend to Egypt Eximbank guarantees and insurance to import U.S. products. With conditions attached (such as compliance with an IMF program), the U.S. Government initiated similar programs for Brazil and Mexico, authorizing Brazil to use Eximbank guarantees and insurance for up to $1.5 billion and Mexico for up to $500 million.

One policy difficulty with providing additional assistance to Egypt is that it might delay efforts by the Government of Egypt to come to terms with the causes of its economic problems. The Egyptian Government has approached U.S. Treasury officials on rescheduling its Foreign Military Sales (FMS) debt only. Treasury responded that the U.S. Government provides debt relief solely in the context of a multilateral arrangement such as the Paris Club. This process assures that the burden of relief is shared by all creditors and is combined with an economic stabilization program, which addresses the causes of the debt problem and ensures eventual repayment.

In the case of Egypt the major cause of its economic problems is Egypt's large budget deficits resulting from (1) massive domestic subsidies and (2) heavy reliance for budgetary revenue on exogenous factors such as tourism, remittances from Egyptians working abroad, petroleum and fees on transport through the Suez Canal -- the last three are greatly affected by world oil demand.

BACKGROUND

Assistance provided Egypt in FY 83

A. Wheat and Wheat Flour

1. In January 1983, the Secretary of Agriculture announced agreement to sell 1 million tons (plus or minus 5 percent) of U.S. wheat flour for shipment to Egypt over a 12 to 14 month period beginning March 1, 1983. The agreed C&F selling price was $155 per metric ton. The CCC provided 1.23 million metric tons of wheat from its stocks to millers willing to accept the smallest amount of CCC wheat to export the wheat flour to Egypt at this price. The GSM-102 program guaranteed $123.8 million of the financing at commercial interest rates for 3 years (98 percent of the principal and 8 percentage points of applicable bank interest charges.)

2. The USG provided blended credits for another $55 million worth of wheat, or 500,000 metric tons (assuming a price of $130 per ton).

3. Under P.L. 480 (Title I), we sold Egypt $250 million of wheat and wheat flour, of which $89 million was flour. This represents 1.46 million tons of wheat and flour on a grain equivalent basis.

B. Dairy Products

-- In August 1983, the U.S. Government, through the CCC, sold 28,000 metric tons of dairy products from its stocks to the Government of Egypt. The sale, which had a value of about $42.2 million, consisted of 18,000 metric tons of butter, 6,000 metric tons of cheddar cheese, and 4,000 metric tons of processed cheese. The transaction was made at world market prices and will be paid for in Egyptian pounds for use by the American Embassy in Cairo for its official expenditures.

C. Other Assistance

-- Blended credit on all other products to Egypt was $112.5 million.

-- Under P.L. 480 (Title II), a grant of $14 million in food aid was provided.

<u>Planned Assistance for Egypt During FY 84</u>

A. Wheat and Wheat Flour

1. The U.S. Government expects to provide Egypt with $250 million in P.L. 480 (Title I) for wheat and wheat flour, of which $90 million will be flour. USDA estimates that Egypt will be able to use the P.L. 480 to import 1.492 million metric tons of wheat and wheat flour on a grain equivalent basis.

2. USDA expects to offer $120 million in blended credits to Egypt to purchase 750,000 metric tons of wheat (up to $17 million in GSM-5 interest-free direct credits, exact figure depends on negotiation, and $115.5 million in GSM-102 loan guarantees). This sale should give the United States half of the EC's previous share of the Egyptian wheat market.

B. Other Assistance

-- The U.S. Government expects to provide P.L. 480 grants under Title II of $17.5 million.

-- The NAC approved $116 million in 3-year GSM-102 guarantees to finance Egyptian imports of tobacco and food products.

<u>Discarded Food Assistance Options</u>

The IG-IEP considered but rejected the following options for providing food assistance to Egypt.

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A. Additional P.L. 480.

-- The Administration is committed to Congress to reduce the allocation of P.L. 480 to Egypt from $250 million in FY 84 to $225 million in FY 85. Some in Congress are concerned that too large a percentage of P.L. 480 assistance goes to Egypt (34 percent in FY 84).

B. Earmark part of the $750 million from the Economic Support Fund (ESF) for Egypt to purchase flour or other agricultural commodities under the Commodity Import Program (CIP), which provides grants. CIP has been used for corn.

-- Does not provide new assistance to Egypt, only shifts funds from one project to another.

C. The current allocated funding for P.L. 480 wheat could be used instead for flour, and wheat could be offered under GSM-102 or blended credits (GSM-5/GSM-102). The current P.L. 480 wheat allocation is $160 million, to cover approximately 958,000 metric tons. If this funding is used for flour, it would cover 693,000 tons of additional flour which would displace flour from the EC. The 958,000 tons of wheat would then be offset by an additional GSM-102 funding allocation of $160 million. In return Egypt would agree to commit to use a portion of ESF monies to purchase poultry.

-- Because EC wheat flour is substantially cheaper than ours, this option is not economically advantageous for Egypt. The poultry purchase would hurt Brazilian poultry exports, which at present are not receiving significant export subsidies. This option is now overtaken by events. We have proceeded with our P.L. 480 allocation for Egypt based on the original USDA proposal.

D. Sell 50,000 to 60,000 metric tons of whole broilers to Egypt. CCC surplus dairy products would be used to make U.S. poultry competitive with subsidized poultry from the EC and Brazil.

-- The TPC on October 25 rejected this proposal. It would hurt Brazilian poultry exports, which at present do not receive significant export subsidies.

E. Provide interest-free direct credits under CCC GSM-5.

-- Straight GSM-5 requires a greater budgetary outlay than blended credits for the same amount of U.S. exports. The extra expense is not warranted.

F. Offer Eximbank insurance for Egyptian agricultural imports.

-- The terms are not generous. Egypt would pay commercial interest rates. The maximum repayment period is 360 days after the time of importation. Egypt is not likely to be interested.

G. Reactivate GSM intermediate (3-10 year) financing. Under this program, the local currency the Egyptians receive from the sale of the wheat flour must go to financing storage facilities and other projects that will facilitate importing.

-- The program has not been used because of the administrative burden of operating a counterpart funding program. Intermediate financing is unwarranted for consumer goods and is inconsistent with commercial practice. It would anger the Canadians and the Australians and come under attack in the FAO Committee on Surplus Disposal.

